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In the Supreme Court of the United States

OCTOBER TERM, 1969

No. 402

UNITED STATES OF AMERICA, PETITIONER
v.
SHELDON A. KEY, TRUSTEE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The order of the district court confirming the plan of reorganization (R. 58–63)[1] is not officially reported. The opinion of the court of appeals (R. 74–80) is reported at 407 F. 2d. 635.

JURISDICTION

The judgment of the court of appeals was entered on February 27, 1969 (R. 81). On May 20, 1969, Mr. Justice Marshall extended the time for filing a petition for a writ of certiorari to and including July 27, 1969. The petition for a writ of certiorari was filed on July 28, 1969 (July 27, 1969, being a Sunday), and

[1] "R." references are to the separately bound record appendix.

was granted on October 20, 1969. The jurisdiction of this Court is conferred by 28 U.S.C. 1254 (1).

QUESTIONS PRESENTED

1. Whether the Secretary of the Treasury's rejection of a debtor's proposed plan of voluntary corporate reorganization under Chapter X of the Bankruptcy Act entitles the United States to have its unpaid tax claims first satisfied under Section 3466 of the Revised Statutes.

2. If the United States is not entitled to priority of payment, whether it must accept payment later in time than junior creditors and without provision for interest during the period of delay.

STATUTES INVOLVED

The pertinent provisions of Revised Statutes, Section 3466, and of Sections 102, 107, 115, 197, 199, 216, and 221 of the Bankruptcy Act, as amended, are set forth in the Appendix, *infra,* pp. 41–44.

STATEMENT

On May 3, 1954, Hancock Trucking, Inc. (the debtor), filed a voluntary petition for corporate reorganization under Chapter X of the Bankruptcy Act, as amended, in which it alleged that it was unable to meet its debts as they became due and requested the appointment of a trustee to operate its business and manage its property (R. 74). The United States filed proofs of claim for unpaid withholding of federal income, employment and excise taxes in the amount of $377,648.79 (R. 5–8, 21–22, 74).

An initial reorganization plan was confirmed by the district court in 1957 but, for reasons not relevant here, it was never consummated.[2] Subsequently, with district court approval, the debtor agreed with Hennis Freight Lines, Inc. that Hennis would purchase its major asset, its Interstate Commerce Commission operating rights for truck freight services. The agreement provided that Hennis would pay not more than $935,000 for the rights—$300,000 within 90 days of the Commission's approval of the sale and the balance in 78 monthly installments. The Commission approved the sale, with modifications, in March, 1965 (R. 9–11, 12–20, 23–28, 40–43, 75).

On June 23, 1967, the trustee filed an amended plan of reorganization, the terms of which reflected this underlying sale. The $300,000 down payment was to be exhausted by paying 100 percent of certain wage and local and state claims, 20 percent of the claims of the unsecured creditors, and 10 percent of the United States' tax claims and other state and local tax claims. The remainder of the amount due to the United States and to state and local tax authorities was to be paid in 78 monthly installments, secured by an assignment of the note and chattel mortgage Hennis had executed on its pur-

[2] Under this plan, the United States and certain states were to be paid 25 percent of their tax claims in cash upon confirmation, and the balance in four quarterly installments, with six percent interest on the unpaid balance. The plan also provided an acceleration clause in favor of the United States in the event of default. The United States had indicated that it would accept this plan.

chase of the debtor's operating rights. No interest was to be paid in connection with the installment payments, and the plan did not contemplate the continued existence of the debtor (R. 43–45, 64–70, 74–75).

The Secretary of the Treasury filed a timely notice that he rejected the amended plan (R. 51, 75), but, following a hearing, the district court nonetheless confirmed it (R. 58–63, 75). Upon appeal by the United States from the order of confirmation (R. 71), the court of appeals affirmed (R. 74–80).

ARGUMENT

INTRODUCTION AND SUMMARY

The present case involves the meaning and interaction in a reorganization under Chapter X of the Bankruptcy Act of three sets of statutory provisions:

> (1) Section 3466 of the Revised Statutes, 31 U.S.C. 191, which provides in straightforward terms that "[w]henever any person indebted to the United States is insolvent * * * the debts due to the United States shall be first satisfied";
>
> (2) Section 199 of the Bankruptcy Act, 11 U.S.C. 599, which provides as to federal tax claims against both solvent and insolvent corporations in reorganization, that "no plan which does not provide for the payment thereof shall be confirmed by the judge except upon the acceptance of a lesser amount by the Secretary of the Treasury * * *";
>
> (3) Sections 216 and 221 of the Act, 11 U.S.C. 616, 621, which require that a plan of reorganization must "equitably and fairly"

> protect the value of claims made by "any class of creditors which is affected by and does not accept the plan," without specific reference to the United States, and that the "judge shall confirm a plan if satisfied that—(1) the provisions of * * * section 199 * * * have been complied with; and (2) the plan is fair and equitable * * *."

The questions of meaning which arise in this case include the following: What is required by the mandate of Section 3466 that debts due the United States be "first satisfied"? What constitutes "payment" of tax claims under Section 199 and what is "a lesser amount"? What, under Sections 216 and 221, constitutes "fair and equitable" protection of the claims of a class of creditors?

The principal question of interaction among the statutory provisions involves the relationship between Section 199 and Section 3466—whether the "payment" requirement can be met only if the government's tax claims are "first satisfied," and, if not, whether in Chapter X proceedings provision for "payment" is enough. In addition, there is a question of the relationship between Section 199 and Sections 216 and 221—whether a provision for "payment" under Section 199 is, *ipso facto,* "fair and equitable" to the United States under the latter sections.

The plan which the courts below approved as "payment" of the government's claim, and therefore "fair and equitable," provides for an initial payment—on the government's total claim of $375,400—of approximately $37,500 and 78 equal monthly installments of

approximately $4,330. The Revenue Service informs us that the present value of the right to receive monthly payments in that amount for 78 months, figuring six percent interest compounded semi-annually, is approximately $280,000; thus the total package of initial payment and installments, under this hypothesis, would be worth approximately $317,000. On the other hand, if the United States is entitled to be paid first, allowing $90,000 for administrative expenses and $14,500 for the few claims which may have priority,[3] it would receive $271,000 at once,[4] and thirteen monthly installments of approximately $8,140. The value of this package is insignificantly less than the government's total claim of $375,400. We submit that the scheme of payment approved below fails to satisfy the rights of the United States under each of the three applicable statutes.

We seek to show, first, that the long established general requirement of Section 3466, that debts of an insolvent debtor to the United States must be "first satisfied", entitles the United States to absolute priority of payment of its claims in a Chapter X reorganization. Such priority covers tax debts as well as other debts, and on the facts of this case it is indisputable that the debtor is insolvent; thus, the provi-

[3] It appears from respondent's brief below that there are approximately $14,500 of claims ranked as Class I, entitled to priority over the government's claim, which is the sole claim ranked as Class II. Ct. App. Br. p. 34, n. 9; cf. App. 64.

[4] The insolvent's estate has $75,000 available for immediate payment in addition to the $300,000 down payment from Hennis Freight Lines. (Resp. Opp. 6.)

sion applies by its plain language. Nor is there any inconsistency with Section 199 that would justify the conclusion below that Section 3466 has been displaced in Chapter X reorganization cases. Indeed, Chapter X reorganizations are the direct statutory descendants of equity receivership proceedings, to which the applicability of Section 3466 is firmly established. An extensive review of the legislative background of Section 199—which applies in terms to reorganizations of solvent as well as insolvent debtors—reveals that the Congress was aware of the government's absolute priority in insolvency cases and had no purpose to rescind it; rather, the section was viewed as carrying forward the established practice under equity receiverships, which recognized that priority.

Section 199 speaks of "payment" as contrasted with "acceptance of a lesser amount." This contrast, illumined by the economic realities of the present case, evidently implies that the government is entitled to the maximum payment which can be made to it in view of the funds available to pay its claim. As shown above, here it received, in return for its claim, a bundle of rights worth less than $320,000; but the available funds could, and therefore should, have been allocated in a manner which would have given the United States value almost equivalent to the amount of its claim. In addition, the installment payment feature required the United States to bear whatever risks might arise relative to consummation of the plan, further reducing the present value of the government's award. It is thus clear that the government

has improperly been given "a lesser amount," rather than "payment" of its claim.

Finally, the reference in Sections 216 and 221 to "fair and equitable" treatment of creditors draws on a settled body of law under which senior creditors must be fully satisfied before junior creditors are paid, and any plan under which juniors receive something of value at the expense of senior creditors "comes within judicial denunciation." *Consolidated Rock Co.* v. *Du Bois,* 312 U.S. 510, 529. Since the present plan provides junior creditors with immediate, partial payment of their claims at the cost of requiring the government to accept delayed and therefore discounted payment of its claims and to bear the risk that the installment purchase contract will fail, it is not fair and equitable within the statutory contemplation.

I

THE UNITED STATES IS ENTITLED TO ABSOLUTE PRIORITY OF PAYMENT UNDER SECTION 3466 OF THE REVISED STATUTES

Since virtually the beginning of the Republic, Section 3466 and its predecessors have guaranteed an unqualified priority of payment for all "debts due to the United States" by an insolvent debtor.[5] This

[5] We are not concerned with the relative priority of the government's claims under Section 3466 vis-à-vis prior, specific and perfected liens upon the debtor's property at the time of insolvency, where there had been a transfer of the debtor's property and the debtor had no estate to which the government's priority could attach. Cf. *New York* v. *Maclay,* 288 U.S. 290,

policy had its roots in established English practices under which the Crown enjoyed an absolute priority over all other creditors of an insolvent debtor. This deference, attributed to royal prerogative, was based on the necessity of preserving government revenue.[6] In the United States, the sovereign priority was carried forward by explicit statutes. *United States* v. *State Bank of North Carolina,* 6 Pet. 29; *United States* v. *Oklahoma,* 261 U.S. 253. Although initially the priority was only for debts due on bond and for customs duties, see Act of July 31, 1789, c. 5, 1 Stat. 29, Section 21, by 1799 all debts due the United States out of the estate of an insolvent debtor were entitled to such priority of payment, under a statute whose language has since remained substantially unchanged. See, *e.g.,* Act of March 3, 1797, c. 20, 1 Stat. 512, Section 5, as amended by the Act of March 2, 1799, c. 22, 1 Stat. 627, Section 65.[7]

294; *United States* v. *Texas*, 314 U.S. 480, 484–485; *United States* v. *Waddill Co.*, 323 U.S. 353, 355–356; *Illinois* v. *Campbell*, 329 U.S. 362, 370–372; *Massachusetts* v. *United States*, 333 U.S. 611, 634, n. 38; *United States* v. *Gilbert Associates*, 345 U.S. 361, 365–366; *Commonwealth of Kentucky, Dept. of Rev.* v. *United States*, 383 F. 2d 13, 15 (C.A. 6). There does not appear to be any claimant in the Chapter X proceedings in the present case with prior specific liens upon the debtor's property.

[6] See 33 Hen. VIII, c. 39, § 74; 13 Eliz. I, c. 4.

[7] See also Act of August 4, 1790, c. 35, 1 Stat. 145, Sec. 45; Act of May 2, 1792, c. 27, 1 Stat. 259, Sec. 18; Act of March 3, 1797, c. 20, 1 Stat. 512, Sec. 5; Act of March 2, 1799, c. 22, 1 Stat. 627, Sec. 65.

This statutory priority is now established by Revised Statutes Section 3466, which provides as follows:

> Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

The statutory purpose is to advance the same public policy which governed the English royal prerogative, *i.e.,* to secure an adequate revenue to sustain the public burdens and discharge the public debts. *United States* v. *Fisher,* 2 Cranch 358, 391–392; *United States* v. *State Bank of North Carolina,* 6 Pet. 29, 35. The terms of the statute are to be liberally construed to effectuate this public purpose. *Beaston* v. *Farmers' Bank,* 12 Pet. 102, 135; *Bramwell* v. *U.S. Fidelity Co.,* 269 U.S. 483, 487; *Price* v. *United States,* 269 U.S. 492, 499–501.

It is settled that a tax debt to the United States—such as is in question here—is covered by the broad language of Section 3466. *Price* v. *United States, supra,* at 499; *Spokane County* v. *United States,* 279

U.S. 80, 92–93; *Illinois* v. *United States,* 328 U.S. 8, 9; *Illinois* v. *Campbell,* 329 U.S. 362, 366–367; *Massachusetts* v. *United States,* 333 U.S. 611, 625–626. Nor is there any dispute that the debtor in this case is insolvent within the meaning of the statute. On several occasions, the debtor has admitted its insolvency, and the district court has so adjudged. The trustee was appointed following a voluntary petition by the debtor consenting to a reorganization and confessing insolvency. Likewise, the debtor's financial situation is such that upon the discontinuance of its business and the sale of its assets, the proceeds of sale will be insufficient to pay all its debts (R. 12, 23–24, 62). Thus, there have been both a voluntary assignment and an act of bankruptcy to bring this debtor within the scope of Section 3466.[8] See *United States* v. *Emory,* 314 U.S. 423.

In these circumstances, there is on the face of things no reason why Section 3466 would not apply so as to give the United States an absolute priority for the payment of this debtor's taxes. The court of appeals, however, believed that Section 199 of the Bankruptcy Act, which governs government tax claims in Chapter X reorganizations to the extent of establishing the principle that no reorganization plan may be confirmed

[8] Under Section 3a of the Bankruptcy Act, as amended (11 U.S.C. 21(a)), the fifth act of bankruptcy consists of a person having—

"* * * (5) while insolvent or unable to pay his debts as they mature, procured, permitted, or suffered voluntarily or involuntarily the appointment of a receiver or trustee to take charge of his property; * * *."

unless it provides for "the payment" of such claims (or unless the Secretary of the Treasury consents to less than full payment). The court of appeals regarded Section 199 as a more specific and later enactment superseding "the more general and conflicting direction of § 3466" (R. 79).

But there is no inconsistency or anomaly in applying both sections in a Chapter X reorganization. Section 199 applies to both solvent and insolvent corporations, and provides simply that the United States cannot be compelled to accept less than full payment of its taxes. If, as here, the Secretary of the Treasury insists upon payment, the wholly separate question of priority for that payment then arises. Section 199 does not purport to answer the priority question; in the case of an insolvent corporation like the debtor here, the general provision of Section 3466 does answer it, stating that the United States is entitled to payment first if it insists upon it. Thus, far from being inconsistent, the two statutes dovetail perfectly in the situation presented by this case.[9] And, as we shall show in Part II of the Argument, the legislative history of Section 199 shows no congressional intent to displace the general priority statute; indeed, Chapter X reorganizations are the direct statutory de-

[9] Thus, Chapter X differs from liquidation bankruptcy, as to which the Bankruptcy Act prescribes in Section 64, 11 U.S.C. 104, a complete system of priorities that does plainly supersede Section 3466. See *United States* v. *Marxen*, 307 U.S. 200. There is no comparable general provision in Chapter X, and Section 102 of the Bankruptcy Act expressly makes Section 64 inapplicable to Chapter X reorganizations.

scendents of equity receivership proceedings, in which the applicability of Section 3466 was clearly established. See *Lowden* v. *N.W. National Bank,* 298 U.S. 160, 163.

Other courts of appeals have applied the unequivocal language of Section 3466 to give the United States first access to insolvents' assets in Chapter X reorganizations. *United States* v. *Anderson,* 334 F. 2d 111 (C.A. 5), certiorari denied, 379 U.S. 879; *In re Cherry Valley Homes, Inc.* 255 F. 2d 706 (C.A. 3), certiorari denied *sub nom. Du Bois* v. *United States,* 358 U.S. 864, *Reconstruction Finance Corp.* v. *Flynn,* 175 F. 2d 761 (C.A. 2), certiorari denied, 338 U.S. 819. To be sure, these cases involved non-tax debts owed to the government. But there is nothing in the simple language of Section 3466 that would provide any basis for distinguishing between tax debts and other kinds of debt.

Indeed, in *United States* v. *Anderson, supra,* the Fifth Circuit reasoned from the assumption that the government would have Chapter X priority in tax debt cases to its conclusion on the only disputed point, whether it also had priority as to non-tax debts. The government's claims in the Chapter X proceedings in *Anderson* included tax as well as non-tax debts; the district court accorded the tax debts priority and denied it only as to the non-tax debts. 334 F. 2d at 113, n. 2. Then it was argued in the court of appeals that this differentiation was proper, because Section 199 specifically provided for tax debt priority in Chapter X proceedings, but there was no similar statement regarding other government debts. The

Fifth Circuit refused to draw that inference in light of the long history of undifferentiated government priority under Section 3466 of the Revised Statutes and the distinct functions of Section 199 in cases not involving insolvency. *Id.* at 116–117.[10]

II

THE HISTORY OF CHAPTER X GENERALLY, AND SECTION 199 IN PARTICULAR, SHOWS NOT ONLY THAT THE ABSOLUTE FEDERAL PRIORITY IS UNIMPAIRED BUT ALSO THAT THE UNITED STATES HAS INDEPENDENT RIGHTS NOT SATISFIED IN THE DECISION BELOW

A. THE HISTORY

Until the enactment of the first federal corporate reorganization provisions in 1933 and 1934, the principal method of reorganizing insolvent corporations was the federal equity receivership. This was a judge-made procedure developed in the nineteenth century to protect railroads from dismemberment by their creditors. Unlike ordinary bankruptcy, this procedure was designed to rehabilitate a debtor in financial straits and to preserve its business as a going concern. Briefly, the court created a receivership to prevent the corporation's creditors from enforcing their claims against the property of the debtor; a judicial sale was held of that property to the creditors, free

[10] It would be anomalous if the government were entitled to a priority in payment of the full amount of its nontax claims but denied this priority for its tax claims, nothwithstanding that Congress has given the government greater protection for its tax and customs claims than for its other claims.

of the old debts; and the property was conveyed by the creditors to a new company formed for the purpose of carrying on the enterprise. The court's jurisdiction was founded on the existence of a limited fund which was less than the claims against it, thus necessitating the intervention of the court to assure an equitable distribution among the creditors. See, Finletter, *The Law of Bankruptcy Reorganization,* pp. 1–17 (1939).

A long line of cases established that Section 3466 of the Revised Statutes gave the United States—as its literal language suggested—an absolute priority for payment of debts due it from an insolvent corporation in equity receivership. *E.g., Price* v. *United States,* 269 U.S. 492, 502–503; *United States* v. *Butterworth Corp.,* 269 U.S. 504, 513; *Spokane County* v. *United States,* 279 U.S. 80; *New York* v. *Maclay,* 288 U.S. 290; *United States* v. *Emory,* 314 U.S. 423, 433; *Illinois* v. *Campbell,* 329 U.S. 362, 366–367; *United States* v. *Gilbert Associates,* 345 U.S. 361, 365. See also, Blair, *The Priority of the United States in Equity Receiverships,* 39 Harvard L. Rev. 1 (1925).

The first corporate reorganization statute was the Act of March 3, 1933, c. 204, 47 Stat. 1467, Section 1, which added Section 77 to the Bankruptcy Act to regulate railroad reorganizations. It brought railroads under the jurisdiction of the bankruptcy court, but with a procedure radically different from that of a liquidating bankruptcy and more closely resembling equity receivership. See H. Rep. No. 1897, 72d Cong.,

2d Sess., pp. 5, 8 (S.L.A. 18–19) [11]; S. Rep. No. 1215, 72d Cong., 2d Sess. (S.L.A. 20–38). Insofar as is relevant here, Section 77(e)(1), as enacted in 1933, provided:

> If the United States of America is directly a creditor or stockholder, the Secretary of the Treasury is hereby authorized to accept or reject a plan in respect of the interests or claims of the United States.

This provision was not intended to affect the priority of the government's claims. It resulted, instead, from two prior rulings of the Attorney General that the Secretary of the Treasury lacked authority to compromise claims of indebtedness owed to the government by the railroads. 33 Op. A. G. 423 (1923) (S.L.A. 1–6); 34 Op. A. G. 108 (1924) (S.L.A. 7–13). The Secretary requested Congress to give him such authority, and Section 77(e)(1) did so. See Criticisms and Suggestions Relating to H.R. 14359 and S. 5551, Amending the Bankruptcy Act (1933), pp. 19–20 (S.L.A. 16–17).

The Act of June 7, 1934, c. 424, 48 Stat. 911, Section 1, added Section 77B to the Bankruptcy Act in order to extend these reorganization procedures to private corporations generally. It too adopted the general concepts of equity receivership. See H. Rep. No. 194, 73d Cong., 1st Sess. (S.L.A. 39–51); S. Rep. No. 482, 73d Cong., 2d Sess. (S.L.A. 52–66). Section

[11] "S.L.A." references are to a separately bound Supplemental Legislative Appendix, copies of which are being lodged with the Clerk and served upon counsel for the respondent. It includes legislative materials not readily available elsewhere.

77B(e)(1), like Section 77(e)(1), authorized the Secretary of the Treasury to accept or reject a plan.

In 1935, the Secretary of the Treasury called the attention of Congress to the fact that lower federal courts were interpreting Section 77B(e)(1) to defeat the government's priority, placing it in the status of a general creditor with regard to its claims for taxes; as a result, the government ran a risk of losing millions of dollars of tax revenues. In order to remedy this situation, Congress amended Section 77B(e)(1) by the Act of August 29, 1935, c. 809, 49 Stat. 965, 966, which introduced the predecessor of Section 199, as follows:

> If the United States of America is a creditor or stockholder, the interests or claims thereof shall be deemed to be affected by the plan, and the Secretary of the Treasury is hereby authorized to accept or reject a plan in respect of the interests or claims of the United States. If, in any reorganization proceeding under this section, the United States is a creditor on claims for taxes or custom duties (whether or not the United States has any other interest in, or claim against, the debtor, as creditor or stockholder), no plan which does not provide for the payment thereof shall be confirmed by the judge except upon the acceptance of a lesser amount by the Secretary of the Treasury certified to the court: *Provided,* That if the Secretary of the Treasury shall fail to accept or reject a plan for more than ninety days after receipt of written notice so to do from the court to which the plan has been proposed, accompanied by a certified copy of the plan, his consent shall be conclusively presumed.

See S. Rep. No. 953, 74th Cong., 1st Sess. (S.L.A. 67); H. Rep. No. 1366, 74th Cong., 1st Sess. (S.L.A. 68–70); S. Rep. No. 1386, 74th Cong., 1st Sess. (S.L.A. 71–74).[12]

A similar amendment was made to Section 77(e), relating to railroad reorganizations, by the Act of June 26, 1936, c. 833, 49 Stat. 1969. In pertinent part, S. Rep. No. 1985, 74th Cong., 2d Sess., pp. 2–3 (S.L.A. 76–77), stated as follows with respect to that amendment:

> Since the beginning of our Federal Government, Congress has consistently maintained a policy of preferring claims of the United States in insolvency and bankruptcy proceedings over those of general creditors. Section 3466 of the Revised Statutes (U.S.C., title 31, sec. 191) requires that debts due the United States shall

[12] When the bill was before the Senate, Senator Burke, the floor manager, explained it as follows (79 Cong. Rec. 14101):

"* * * [Under] section 77B of the Bankruptcy Act, the Secretary of the Treasury is authorized to accept or reject corporation reorganization plans in which the United States is interested. It was assumed when that act was passed that the United States Government would have preferential treatment in its claims for taxes, customs duties, and so forth, but the courts have held otherwise. So, at the request of the Treasury Department, identical bills were introduced in the House and Senate to make that point clear."

As for the operation of the provision, Senator Gerry asked (*ibid.*): "And that prevents a reorganization until the taxes have been paid?" Senator Burke responded (*Id.*, pp. 14101–14102):

"Yes; or until the Secretary of the Treasury has agreed, on behalf of the Government, to accept a percentage, or to waive the claim altogether. The reorganization may not be put through, if the United States has a claim for taxes or customs duties, without the consent of the Secretary of the Treasury."

be satisfied first, where a debtor's or decedent's estate is insolvent. In recognition of the policy of that provision, and of the underlying necessity for protecting the revenues of the Government against the contingencies of insolvency, the Supreme Court has given it a liberal construction, and held that the word "debts" includes unpaid taxes (*Price* v. *United States,* 269 U.S. 492 (1926)). This policy is further manifested in the provisions of all of the bankruptcy acts enacted by Congress (*City of Waco* v. *Bryan,* 127 Fed. 79 (C.C.A. 5th, 1904)). * * *

* * * * *

It will be noted that S. 3841 is much more flexible and much less drastic than either section 3466 of the Revised Statutes, or section 64 of the Bankruptcy Act. The former gives a first claim upon the assets of the insolvent's estate to debts due the United States. The latter gives both to tax claims and to other debts due the United States (which are entitled to priority under section 3466) a definite place among those debts which are preferred over the claims of general creditors. S. 3841, on the other hand, like the amendment to section 77B, gives to the President, or the officer designated by him, an opportunity to accede to any proposition which protects the revenue, and which, at the same time, is not so burdensome upon the debtor as to impair its ability to regain a sound financial status. The bill entitles the Government to preferred treatment only as to claims for taxes and customs duties. Such treatment is not accorded other debts due the United States, in spite of

> the fact that Congress' continued policy would so warrant.

See also, H. Rep. No. 2926, 74th Cong., 2d Sess., pp. 4–6 (S.L.A. 78–80).[13]

The legislative history of the Chandler Act, which is the basis of the present Bankruptcy Act, shows clearly that Congress was fully aware of the extent to which the priority of payment of the government's tax claims were protected under Section 3466 and was specifically concerned to provide protection to the government not only as to insolvent debtors, but more generally as to all debtors involved in Chapter X reorganizations.[14]

The first draft bill was prepared in 1932 (S.L.A. 87–93). It included a provision, Section 76, dealing

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[13] A similar provision was included in Chapter XV, Section 722 of the Bankruptcy Act, as amended, as added by the Act of July 28, 1939, c. 393, 53 Stat. 1134, relating to the voluntary adjustment of railroad obligations. See Senate Hearings before the Committee on Interstate Commerce on Railroad Reorganization Act of 1939, 76th Cong., 1st Sess., pp. 78–80 (1939) (S.L.A. 82–84); S. Rep. No. 489, 76th Cong., 1st Sess., p. 6 (S.L.A. 85); H. Conference Rep. No. 1320, 76th Cong., 1st Sess., p. 8 (S.L.A. 86).

[14] Extensive hearings were held by Congress through the 1930's to consider a general revision of the Bankruptcy Act. These ultimately resulted in the Act of June 22, 1938, c. 575, 52 Stat. 840, the so-called Chandler Act. At the same time Congress was also concerned with the plight of many classes of debtors caused by the depression. As a result, various provisions for the relief of debtors were included in the draft proposals for a general revision of the Bankruptcy Act and, concurrently, a number of bills were separately introduced to provide immediate relief for special classes of debtors. Sections 77 and 77B resulted from such bills.

with corporate reorganizations, but did not refer specifically to the payment of federal taxes. The next five drafts were prepared by the National Bankruptcy Conference. The first three of these, all prepared in 1933, provided for corporate reorganizations in a proposed Section 78. The first draft (S.L.A. 94–96) made no reference to payment of federal taxes; but the second (S.L.A. 97–99) and third drafts (S.L.A. 100–102) each would have authorized the Secretary of the Treasury to represent the United States and to accept or reject a proposed plan, as in the initial version of Section 77B(e)(1). The fourth (S.L.A. 103–109) and fifth Bankruptcy Conference drafts (S.L.A. 110–114), prepared in 1935 and 1936, respectively, dealt with corporate reorganizations in a proposed Section 12 as part of a package of various debtor relief provisions, but omitted the provision authorizing the Secretary to accept or reject plans. The fifth draft was introduced into the House by Representative Chandler as H.R. 10382, 74th Cong., 2d Sess. (S.L.A. 110–114).

Later in that session, the same Congress considered H.R. 12889 (S.L.A. 115–121). The proposed Section 12(II)d(5) of this bill, also drafted by the National Bankruptcy Conference, spelled out in detail the authority of the Secretary to represent the United States, but omitted any requirement that taxes must be paid in full, since the Conference opposed continuation of these rights to the government. Congress, however, disagreed, and Section 12(II)h(5) of H.R. 6439, 75th Cong., 1st Sess. (S.L.A. 122–123), introduced approximately one year later, contained a provision for

payment of tax claims almost identical with the present Section 199 and similar to Section 77B(e)(1) as it had been amended by the 1935 Act (see p. 17, *supra*). The final bill, H.R. 8046, 75th Cong., 3d Sess. (S.L.A. 127–128), was introduced in 1937 and enacted in 1938; it transferred the corporate reorganization provisions from Section 12 to a separate Chapter and included Section 199 in its present form.

During the hearings on the various bills very little opposition was expressed to the reinstatement of the Government's right either to a priority of payment or to full payment of taxes. One member of the National Bankruptcy Conference who had helped draft the legislation stated his opposition to the inclusion of such a provision as follows (House Hearings Before the Committee on the Judiciary on the Revision of the Bankruptcy Act, 75th Cong., 1st Sess., p. 298 (1937)) (S.L.A. 124–126):

> This bill puts it in the power of the Government to veto any plan, if it is a creditor. I think that Mr. Teitelbaum will mention that point, but the point is just this, that if the Government is a creditor, it seems to me that it should not be able to say "No", and block a whole plan—it ought to say "No", and have its no counted with the other yeas and noes, and if two-thirds vote "Yes", the Government should be bound.

The Assistant General Counsel of the Treasury refuted the allegations that retention of the government's existing priority under Section 77B(e)(1)

would hamstring reorganizations, as follows (House Hearings, *supra,* pp. 350–351) (S.L.A. 125):

> Now that provision, I believe, has worked very well in practice. I am informed that there is not a single case in which a reorganizing debtor has been forced into liquidation because of inability to arrive at a fair and proper settlement of the governmental tax claim with the officials of the Treasury Department. If the plan of reorganization failed, it has been for some other reason. The Treasury Department has proceeded upon this principle: It has recognized the objective of Congress in the enactment of 77B to enable enterprises which are in trouble to get back onto their feet. On the other hand, the Department has felt that it was not the intention of Congress in enacting that legislation that private pocketbooks should be enriched at the expense of the Treasury of the United States.

Finally, it was clear to all that the proposed Section 199 would carry forward the practice under equity receiverships and Section 77B. Thus, a member of the National Bankruptcy Conference stated (Senate Hearings before a Subcommittee of the Committee on the Judiciary on the Revision of the National Bankruptcy Act, 75th Cong., 2d Sess., p. 77 (1938) (S.L.A. 130)):

> Section 64 of the general bankruptcy act, for example, provides for a fixed priority in the payment of claims. This section deals solely with unsecured claims, only unsecured claims being affected by bankruptcy. To apply it in

> corporate reorganizations—where secured as well as unsecured claims are dealt with—would cause great confusion. To make it clear that section 64 does not apply, we propose this amendment which expressly provides that 64 shall not be applicable to chapter X. The priorities under chapter X would therefore be those used in equity receiverships. That is the present practice under 77B, which expressly provides that section 64 shall not be applicable. When we adopt the same provision here we merely adopt the practice which is already in existence under section 77B.

And Congress made the history and purpose manifest in explaining the form of Section 199 in the final bill, stating (H. Rep. No. 1409, 75th Cong., 1st Sess., p. 55) (S.L.A. 132)):

> Section 199 of chapter X contains in virtually identical form, the provision in section 77B of the act authorizing the Secretary of the Treasury—where the United States of America is a creditor or stockholder of the debtor—to accept or reject a plan in respect of the claims or rights of the United States. * * *

See also S. Rep. No. 1916, 75th Cong., 3d Sess., p. 32 (S.L.A. 133).

B. THE ABSOLUTE PRIORITY THAT THE UNITED STATES HAD IN EQUITY RECEIVERSHIPS UNDER SECTION 3466 IS PRESERVED IN CHAPTER X REORGANIZATIONS OF INSOLVENT CORPORATIONS

The legislative history of the enactment of Chapter X, and particularly of Section 199, emphasizes two points—(1) that corporate reorganizations were not derived from the precedents of liquidating bankruptcy, but had their origins in equity receiverships

and similar debtor relief proceedings,[15] and (2) that when it enacted Section 199 Congress did not intend to eliminate the priority as to all debts of insolvents which the United States had in equity receiverships under Section 3466. Section 199 was necessary because, *inter alia,* the existing priorities established by Section 3466 aided the government only if the corporation undergoing reorganization was insolvent within the meaning of that statute; it was necessary to have general rules applicable to all Chapter X reorganizations. We have found no indication of any Congressional intention that Section 199 or any other provision of Chapter X was intended to supersede the generally applicable provisions of Section 3466, which had—as we have shown, *supra,* p. 15—been universally recognized in the equity proceedings from which Chapter X arose. Congress was aware of the United States' existing priority under Section 3466, and intended to supplement rather than impair it. See *United States* v. *Anderson, supra.*

C. EVEN IF SECTION 199 SUPERSEDED SECTION 3466, ITS PROVISION FOR "PAYMENT" OF THE GOVERNMENT'S TAX CLAIMS IN ITSELF EMBODIES A PRIORITY WHICH WAS NOT SATISFIED BY THE REORGANIZATION PLAN APPROVED IN THIS CASE

Even if this Court should determine that Section 199 does supersede Section 3466 in Chapter X reorga-

[15] This Court pointed out in *Lowden* v. *N. W. National Bank,* 298 U.S. 160, 163:

"A proceeding to reorganize is not a bankruptcy, though an amendment to the bankruptcy act creates and regulates the remedy."

See *Central States Electric Corp.* v. *Austrian,* 183 F. 2d 879, 886 (C.A. 4), certiorari denied, 340 U.S. 917. See also Part III of the argument, *infra.*

nizations, it remains clear from the legislative history that Congress acted in Section 199 to preserve generally, at least as to tax debts, the rights which the United States had previously enjoyed in equity receiverships. In Collier, *Bankruptcy,* Vol. 6A (14th ed. 1969), Section 9.17, this is stated as follows (pp. 269-270):

> The second sentence of § 199 establishes a first priority in payment for claims of the United States for taxes or customs duties, either secured or unsecured, irrespective of whether the United States has any other interest in or claim against the debtor. The priority thus conferred is superior to all other claims against the estate, even to existing and perfected liens which might otherwise be prior. * * *

See also, Finletter, *The Law of Bankruptcy Reorganization* (1939), pp. 1–35, 385, 404. Indeed, the preference over secured claims provided by Section 199 exceeds the general preference given by Section 3466.

The priority given by Section 199 is embodied in the contrast it draws between "payment" and "acceptance of a lesser amount." The comparison made implies that the government is entitled to the maximum payment which can be made to it in view of the funds available to pay its claim. Any other payment would be a "lesser amount" which the Secretary is entitled to refuse.

In the present case, the purchase by Hennis and other funds in the trustees' hands made $375,000 available for immediate distribution to creditors. Only a small proportion of that sum—respondent suggested $105,000 below—could be claimed for administrative

expenses and the small amount of wage claims placed in Class I, ahead of the government in priority of claim. Thus, it would have been possible to pay the government at least $270,000 at once, plus as many of the monthly installments (of $8140 each) as were required to make up the balance of its $375,386.55 claim. Instead, the government is to be paid $37,538.66 in cash and $4,331.38 monthly for 78 months.

This is payment of a "lesser amount" in several respects. As shown above, the rights conferred would have substantially lower present economic value than immediate payment, even if it were certain that the monthly installments would be paid. Moreover, the monthly installment plan requires the United States to assume whatever risks may arise relative to consummation of the plan—for example, that the purchaser will remain solvent throughout the 78 month period and that the collateral for the installment payments, the operating rights, will retain its value. These risks reduce the value of the government's rights still further and thus make it even clearer that it is being required to accept a "lesser amount."

The courts below came to a different conclusion, that the "payment" obligation was satisfied by any scheme which promised to return to the government, as a simple sum, the amount owed it. That reasoning depended in part on the proposition that the United States is not allowed post-petition interest on its claim, *United States* v. *Edens,* 189 F. 2d 876 (C.A. 4), affirmed *per curiam,* 342 U.S. 912, and that rec-

ognition of any difference in value between available modes of paying the government's claim would amount to the payment of such interest. While the first proposition is correct, the second is economically unsound. The roughly $375,000 due to the government cannot now be expanded by assessment of interest on that amount, despite the considerable delay since the insolvency proceedings began; but the government is entitled to its full claim unless the Secretary agrees to accept less, and there is no blinking the fact that under the plan as approved he will be receiving less.

Accordingly, we submit that even if the government has no absolute right to *first* payment under Section 3466, its right to *full* payment under Section 199 entitles it to no less payment than is available at any stage of the proceedings. At the very least, the government is entitled to compensation for the reduced present value of the payments planned to be made in the future.[16]

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[16] The hypothesis that the government receives "payment" under Section 199 so long as it receives all the moneys due to it at some point in time, without reference to when other creditors are paid, leads to an unacceptable result if the element of risk is also considered. Delaying payment to the government relative to other creditors imposes on it an unequal risk of loss if the transaction fails of completion after it has been only partially consummated. Once the juniors were paid, it would be difficult if not impossible for the government to secure satisfaction from them if the risk then materializes. From this perspective, the requirement of full payment would be diaphanous indeed. Congress must have recognized that such a requirement was workable only in conjunction with a right to priority of payment.

III

THE "FAIR AND EQUITABLE" RULE OF SECTIONS 216 AND 221 REQUIRES THAT A TAX CLAIM OF THE UNITED STATES BE PAID BEFORE THE CLAIMS OF LOWER RANKING CREDITORS

The court of appeals considered that giving the United States priority would conflict with Sections 216(7)(d) and 221(2) of the Bankruptcy Act, which require that a plan of reorganization under Chapter X must, in substance, be fair, equitable and feasible. In its construction of the fair and equitable rule, however, the court in effect eliminated the well established distinctions between senior and junior creditors, holding the government entitled to nothing more than reasonable protection. This violated the settled principle that the fair and equitable rule is applicable not to the body of creditors as a whole, but on a class-by-class basis, treating the senior claims first. Each class of claims must be satisfied in full for the rights surrendered, in descending order, before the next junior class may properly be paid in the distribution. If junior creditors receive something of value at the expense of the senior creditors, the plan is not fair and equitable but "comes within judicial denunciation." *Consolidated Rock Co.* v. *Du Bois,* 312 U.S. 510, 529. That in effect is the result of the plan approved below, which is therefore inconsistent even with the rule upon which it purports to be based.

A. THE MEANING OF THE FAIR AND EQUITABLE RULE

Although Chapter X envisages that a reorganization plan will alter or modify the rights of creditors

and stockholders, it imposes conditions on the extent of modification and alteration possible vis-a-vis the rights of others, in order to protect the relative standing which various classes of creditors and equity holders enjoy. Thus, Section 197, 11 U.S.C. 597, requires the reorganization judge to classify creditors and stockholders "according to the nature of their respective claims and stock," and this requirement is understood to call for an ordering based on the priority of claim of the various classes to the debtor's assets. Under Section 216(7)(d), 11 U.S.C. 616(7)(d), if any class of creditors affected by the plan does not accept it, the plan must assure "adequate protection for the realization by them of the value of their claims * * * by such method as will * * * equitably and fairly provide such protection."[17] And Section 221(2) of the Act, 11 U.S.C. 621(2), provides as a condition of confirmation of a plan that the court be "satisfied" that "the plan is fair and equitable, and feasible."

The repeated statement in the Act of the requirement that a Chapter X plan be "fair and equitable"

[17] Since generally, if not inevitably, the United States is the sole member of the class of creditors to which it belongs, the provision for acceptance of the plan by a vote of two-thirds of the amount of debt held by the class is irrelevant to it; the provision thus amounts to a statement that if it rejects a plan, the plan can be adopted only if it equitably and fairly protects the government's realization of the value of its claims. In view of the specific mandate of Section 199 on this issue, it might appear that the section is redundant as to the government in tax cases such as this. Section 221 evidently is not redundant, however, since it makes separate reference to Section 199 and the fair and equitable rule.

draws on a settled tradition of according creditors absolute priority over stockholders in equity proceedings involving a debtor's estate. See, *e.g.*, *Mumma* v. *The Potomac Co.*, 8 Pet. 281, 286–287; *Curran* v. *State of Arkansas*, 15 How. 304, 307–308; *Railroad Co.* v. *Howard*, 7 Wall. 392, 409–410. That principle was regularly applied in the equity receivership proceedings which were the historical source of Chapter X. Thus, in *Northern Pacific Ry.* v. *Boyd*, 228 U.S. 482, a general creditor who was denied participation in the reorganized company sought recovery of the amount of his claim against the new corporation on the ground that by permitting the stockholders to participate in the plan, the latter had received assets belonging to the unsecured creditors. This Court agreed, holding that the reorganizers were bound to recognize the superior rights of the general creditors, and stated, in part, as follows (228 U.S. at 504–505):

> For, if purposely or unintentionally a single creditor was not paid, or provided for in the reorganization, he could assert his superior rights against the subordinate interests of the old stockholders in the property transferred to the new company. * * * The property was a trust fund charged primarily with the payment of corporate liabilities. Any device, whether by private contract or judicial sale under consent decree, whereby stockholders were preferred before the creditor was invalid. * * * "* * * Any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the ex-

> pense of the prior rights of either class of creditors comes within judicial denunciation."

The opinion then set forth what has since become known as the absolute priority rule (at 508):

> If the value of the road justified the issuance of stock in exchange for old shares, the creditors were entitled to the benefit of that value, whether it was present or prospective, for dividends or only for purposes of control. In either event it was a right of property out of which the creditors were entitled to be paid before the stockholders could retain it for any purpose whatever.

The absolute priority rule was carried forward to govern corporate reorganizations under Section 77B of the Bankruptcy Act. As this Court stated in *Case* v. *Los Angeles Lumber Co.* 308 U.S. 106, 115–116, rehearing denied, 308 U.S. 637:

> The words "fair and equitable" as used to § 77B(f) are words of art which prior to the advent of § 77B had acquired a fixed meaning through judicial interpretations in the field of equity * * * reorganizations. * * *
>
> In equity reorganization law the term "fair and equitable" included, *inter alia,* the rules of law enunciated by this Court in the familiar cases of *Railroad Co.* v. *Howard,* 7 Wall. 392; *Louisville Trust Co.* v. *Louisville, N.A. & C. Ry.* Co., 174 U.S. 674; *Northern Pacific Ry. Co.* v. *Boyd,* 228 U.S. 482; *Kansas City Terminal Ry. Co.* v. *Central Union Trust Co.,* 271 U.S. 445. These cases dealt with the precedence to be accorded creditors over stockholders in reorga-

> nization plans. In *Louisville Trust Co.* v. *Louisville, N.A. & C. Ry. Co., supra,* this Court reaffirmed the "familiar rule" that "the stockholder's interest in the property is subordinate to the rights of creditors; first of secured and then of unsecured creditors." * * *

One of the arguments made in *Case,* as in the courts below, was that the absolute priority rights of a dissenting class need not be recognized if a substantial majority of the creditors as a whole had voted for a plan. This Court rejected that argument in strong terms, holding as a matter of law that the rights of the senior ranking creditors must be observed (at 114):

> * * * [W]here a plan is not fair and equitable as a matter of law it cannot be approved by the court even though the percentage of the various classes of security holders required by § 77B(f) for confirmation of the plan has consented. It is clear from a reading of § 77B(f) that the Congress has required both that the required percentages of each class of security holders approve the plan and that the plan be found to be "fair and equitable." The former is not a substitute for the latter. The court is not merely a ministerial register of the vote of the several classes of security holders. All those interested in the estate are entitled to the court's protection. Accordingly the fact that the vast majority of the security holders have approved the plan is not the test of whether the plan is a fair and equitable one. * * *

In *Consolidated Rock Co.* v. *Du Bois,* 312 U.S. 510, this Court referred to the absolute priority rule as follows (at 520–521):

> The full and absolute priority rule of *Northern Pacific Ry. Co.* v. *Boyd,* 228 U.S. 482, and *Case* v. *Los Angeles Lumber Products Co., supra,* would preclude participation by the equity interests in any of those assets until the bondholders had been made whole. * * *

Subsequently, *Marine Properties* v. *Trust Co.,* 317 U.S. 78, 85, 86–87, applied the absolute priority rule to Chapter X. See *Group of Investors* v. *Milwaukee R. Co.,* 318 U.S. 523, 569, 571; *Central States Electric Corp.* v. *Austrian,* 183 F. 2d 879, 885–888 (C.A. 4), certiorari denied, 340 U.S. 917; *Petition of Portland Electric Power Co.,* 162 F. 2d 618, 622 (C.A. 9), certiorari denied *sub nom. Watson* v. *Portland Electric Power Co.,* 332 U.S. 837; *Spitzer* v. *Stichman,* 278 F. 2d 402 (C.A. 2). See also, Collier *op. cit. supra,* Vol. 6A, Section 11.06; Remington, *Bankruptcy* (1961 Rev.), Vol. 11, Section 4584.

Thus, the requirement of fair and equitable treatment is a requirement that creditors having different priorities be separately classified under Section 197 and given the different priority rankings to which their claims entitle them. *Kyser* v. *MacAdam,* 117 F. 2d 232, 237 (C.A. 2); *St. Louis Union Trust Co.* v. *Champion Shoe Mach. Co.,* 109 F. 2d 313, 316 (C.A. 8). A plan is not fair and equitable if creditors of a junior class receive something of value at the expense of a senior class. *In re Utilities Power & Light Corp.,* 29 F. Supp. 763, 769 (N.D. Ill.).

> Any arrangement by which a junior class receives values allocable to a senior class "comes within judicial denunciation." Beginning with the topmost class of claims against the debtor,

each class in descending rank must receive full and complete compensation for the rights surrendered before the next class below may properly participate. [Collier, *op. cit. supra,* Vol. 6A, Section 11.06, pp. 613–617; see also *id.* at 619.]

The court of appeals' conclusion that a grant of priority to the United States would conflict with the "fair and equitable" provisions of Sections 216 and 221 rests on its failure to accept this settled meaning. The court appears to have started from the premise that the fair and equitable rule entitled it to balance interests of junior creditors against those of senior creditors to achieve a suitable compromise—in effect, protecting lower ranking creditors at the expense of those with prior rights. But this Court has made it abundantly clear that compromising the rights of senior creditors to protect their juniors is the antithesis of fair and equitable treatment within the statutory contemplation, whether or not it might appeal to a disembodied sense of justice.[18] See *Case* v. *Los Angeles Lumber Co., supra,* at 114; *Consolidated Rock Co.* v. *Du Bois, supra,* at 520–521, 527, 528–529;

[18] Thus it is irrelevant whether the junior unsecured creditors have, by agreeing to the plan, given up a portion of the dividend they might have expected in the event of liquidation in bankruptcy. It may be noted, however, that the hypothetical bankruptcy distribution would not be made until all priority claims had been satisfied—that is, in the last part of the 78 months installment payment period. Depending on prevailing interest rates and the degree of risk that the installment purchase agreement would be abandoned, a present right to 20 percent could be more valuable than a future expectancy of 27 percent or 32 percent. Indeed, it is the fact that the government as senior creditor has been made to absorb this discount and risk which prompts the present appellate proceedings.

Marine Properties v. *Trust Co.*, 317 U.S. 78, 85–86; *In re 620 Church St. Corp.*, 299 U.S. 24, 27; *Group of Investors* v. *Milwaukee R. Co.*, 318 U.S. 523, 556–558, 562–563, 564–566, 569. See also, Collier *op. cit. supra*, Vol. 6A, Section 11.06, pp. 613–617. When the fair and equitable rule is given the meaning established by this Court's repeated decisions, there is no conflict. Section 3466 establishes the United States as a senior ranking creditor; Section 199 assures that a proposed plan will provide for payment in full of the government's tax claim unless it consents to a reduction; and Sections 216 and 221 aid in determining whether the method of payment adopted satisfies the government's priority rights.

B. THE FAIR AND EQUITABLE RULE IS NOT SATISFIED BY THE REORGANIZATION PLAN APPROVED IN THIS CASE

A reorganization plan "comes within judicial denunciation" under the fair and equitable rule, *Consolidated Rock Co.* v. *Du Bois, supra*, at 529, if it provides junior creditors with something of value at the senior creditors' expense. The present plan calls for such denunciation since it provides junior creditors with immediate, partial payment of their claims at the cost of requiring the government to accept delayed (and therefore discounted) payment of its claims and to bear the risk that the installment purchase contract will fail.

The point, again, is that a choice has been made to favor others at the government's expense. Thus, this is not a case in which the government's priority is recognized but there is only a small amount of cash

on hand to provide a down payment; nor even one in which both junior and senior creditors share ratably in available cash, installment, or security interests. Here, a large sum of money—$375,000—is available for immediate payment, and junior creditors have been given preferential access to it. By requiring the government to accept installment payments, without interest, over a period of 78 months, the court has allotted it substantially less value than it would receive if it shared in the down-payment funds to the extent its priority suggests, or even equally with the other creditors. As senior creditor, it cannot be required to forego part of its rights, the right to be paid out of the first available funds, at least without receiving equivalent compensation in return. *Consolidated Rock Co.* v. *Du Bois, supra; Group of Investors* v. *Milwaukee R. Co.,* 318 U.S. 523; *Petition of Portland Electric Power Co.,* 162 F. 2d 618 (C.A. 9). See also Collier, *op. cit. supra,* Vol. 6A, Section 11.06, pp. 620–621; *Spitzer* v. *Stichman,* 278 F. 2d 402, 405 (C.A. 2). See also, *Protective Committee* v. *Anderson,* 390 U.S. 414, 424. Cf. *Standard Gas & Electric Co.* v. *Deep Rock Oil Corp.,* 117 F. 2d 615, 617 (C.A. 10), certiorari denied, 313 U.S. 564.

We recognize that compromises are "a normal part of the process of reorganization." *Case* v. *Los Angeles Lumber Co., supra,* at 130; *Protective Committee* v. *Anderson,* 390 U.S. 414, 424. We also recognize that lower ranking creditors are not prevented from bargaining their consent to a plan for a higher return on

their claims, and that higher ranking creditors may accept an extended payment or a smaller amount for their claims in order to induce a settlement and to avoid the delays and hazards of protracted court proceedings. On the other hand, as this Court recently emphasized in *Protective Committee* v. *Anderson, supra,* at 424, even in such circumstances the reorganization court has the responsibility of scrutinizing the merits of compromises "to determine that a proposed compromise forming part of a reorganization plan is fair and equitable. *In re Chicago Rapid Transit Co.,* 196 F. 2d 484 (C.A. 7th Cir. 1952)." There is even greater reason for applying the fair and equitable rule where, as here, a priority creditor, such as the United States, refuses to accept a compromise of its rights, as it is permitted by statute to do.

Finally, there is the least possible basis for requiring the government to assume any risk in this case, for the debtor here is no longer operating its business. Whether or not the business could be forced into liquidation, rather than reorganized, is thus a matter of complete indifference to the government, and there is no justification for favoring general creditors in the apportioning of risk and delay. Confirming this plan as "fair and equitable" would only suggest to proponents of future plans, where continuation might appear feasible, that the government could be subjected to even greater discounts and risks. Such a result is entirely inconsistent with the bankruptcy statutes and the interpretation which they have consistently received in this Court.

CONCLUSION

The judgment of the court of appeals should be reversed and the case remanded for further proceedings.

Respectfully submitted.

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APPENDIX

Revised Statutes:

> SEC. 3466. Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.
>
> (31 U.S.C. 191.)

Bankruptcy Act, c. 541, 30 Stat. 544 [as amended by Sec. 1, Act of June 22, 1938, c. 575, 52 Stat. 840]:

> SEC. 102. The provisions of chapter I to VII, inclusive, of this Act shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: *Provided, however,* That section 23, subdivisions h and n of section 57, section 64, and subdivision f of section 70, shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters I to VII, inclusive. * * *
>
> (11 U.S.C. 502.)
>
> SEC. 107. Creditors or stockholders or any class thereof shall be deemed to be "affected"

by a plan only if their or its interest shall be materially and adversely affected thereby. In the event of controversy, the court shall after hearing upon notice summarily determine whether any creditor or stockholder or class is so affected.

(11 U.S.C. 507).

SEC. 115. Upon the approval of a petition, the court shall have and may, in addition to the jurisdiction, powers, and duties hereinabove and elsewhere in this chapter conferred and imposed upon it, exercise all the powers, not inconsistent with the provisions of this chapter, which a court of the United States would have if it had appointed a receiver in equity of the property of the debtor on the ground of insolvency or inability to meet its debts as they mature.

(11 U.S.C. 515.)

SEC. 197. For the purposes of the plan and its acceptance, the judge shall fix the division of creditors and stockholders into classes according to the nature of their respective claims and stock. * * *

(11 U.S.C. 597.)

SEC. 199. If the United States is a secured or unsecured creditor or stockholder of a debtor, the claims or stock thereof shall be deemed to be affected by a plan under this chapter, and the Secretary of the Treasury is hereby authorized to accept or reject a plan in respect of the claims or stock of the United States. If, in any proceeding under this chapter, the United States is a secured or unsecured creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claim against the debtor, as secured or unsecured creditor or stockholder), no plan which does not provide for the payment thereof

shall be confirmed by the judge except upon the acceptance of a lesser amount by the Secretary of the Treasury certified to the court: *Provided,* That if the Secretary of the Treasury shall fail to accept or reject a plan for more than ninety days after receipt of written notice so to do from the court to which the plan has been proposed, accompanied by a certified copy of the plan, his consent shall be conclusively presumed. (11 U.S.C. 599.)

SEC. 216. A plan of reorganization under this chapter—

(1) shall include in respect to creditors generally or some class of them, secured or unsecured, and may include in respect to stockholders generally or some class of them, provisions altering or modifying their rights, either through the issuance of new securities of any character or otherwise;

(2) may deal with all or any part of the property of the debtor;

(3) shall provide for the payment of all costs and expenses of administration and other allowances which may be approved or made by the judge;

* * * * *

(5) shall specify what claims, if any, are to be paid in cash in full;

* * * * *

(7) shall provide for any class of creditors which is affected by and does not accept the plan by the two-thirds majority in amount required under this chapter, adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims, either as provided in the plan or in the order confirming the plan, (a) by the transfer or sale, or by the retention by the debtor, of such property subject to such claims; or (b) by a sale of such

property free of such claims, at not less than a fair upset price, and the transfer of such claims to the proceeds of such sale; or (c) by appraisal and payment in cash of the value of such claims; or (d) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection;

* * * * *

(11 U.S.C. 616).

Sec. 221. The judge shall confirm a plan if satisfied that—

(1) the provisions of article VII, section 199, and article X of this chapter have been complied with;

(2) the plan is fair and equitable, and feasible;

* * * * *

(11 U.S.C. 621).

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